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No.

IN THE
Supreme Court of the United States

ALBERT AND ESTELLE BINDER,
in their individual capacities
and on behalf of all persons similarly situated,

Petitioners,

vs.

IAN R. WILSON, CARY S. FITCHEY, MARK L. STEVENS AND DELOITE & TOUCHE,

Respondents.

On Petition For Writ Of Certiorari To The Ninth Circuit Court Of Appeals

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Is the presumption of reliance afforded to plaintiffs alleging violations of Rule 10b-5 involving both misrepresentations and omissions restricted to claims constituting "primarily omissions"?

2. Does the absence of a presumption of reliance in a Rule 10b-5 case necessarily preclude class action status under FRCP Rule 23 and, in this case, decertification of the class?

3. Is there a presumption that an SEC reporting company's publicly traded stock, which is included in the National Association of Securities Dealer's electronic over-the-counter Bulletin Board trading system (reporting price and volume), is traded in an "efficient market" so as to entitle Rule 10b-5 claimants to a presumption of reliance under the fraud-on-the-market theory of recovery for such claims?

4. Were the plaintiffs, who had been determined to have similar Rule 10b-5 claims against other defendants remaining in the case, entitled to act as representatives of the class in respect of such class claims against Rule 10b-5 defendants against which the plaintiffs had no individual Rule 10b-5 claims?

In the instant case, having previously certified the instant Rule 10b-5 securities fraud case as a class action under Rule 23, the Idaho District Court dismissed all of the named plaintiffs and the class' Rule 10b-5 claims against the respondents and decertified the class, on the basis that such claimants were not entitled to a presumption of reliance under either *Affiliated Ute citizens* or *Basic, Inc.*

because the instant "mixed case" of misrepresentations and omissions alleged by the plaintiffs was "not primarily an omissions case" and the subject securities, of an SEC reporting company which were included for trading in the NASD's electronic over-the-counter "Bulletin Board" trading system during the class period (before such stock was also listed for trading on the Boston Stock Exchange), were not traded in an "efficient market" and, therefore, the claimants were not entitled to the fraud-on-the-market presumption of reliance enunciated by this Court in *Basic, Inc.*

LIST OF PARTIES

All parties to this proceeding, seeking review of the decision of the Ninth Circuit Court of Appeals, appear in the caption as presented on the facing page of this petition. (The following additional parties were named as defendants in the District Court action: Thomas Gillespie, Marie Mullen Gillespie, T. Gordon Sim, Diane Karban and John Good).

TABLE OF CONTENTS

Page

OPINIONS BELOW 1

JURISDICTION 1

STATUTES, REGULATIONS AND RULES INVOLVED 2

STATEMENT OF THE CASE 3

REASONS FOR GRANTING THE WRIT 16

CONCLUSION 28

INDEX TO APPENDIX

Item No. Beg. Page No.

APPENDIX A:
Order and Opinion of the United States Court of Appeals for the Ninth Circuit dated July 26, 1999 (affirming the decision of the District Court of Idaho, denying petition for rehearing and for rehearing en banc). Majority opinion by Judges Skopil and Farris, and dissent by Judge Reinhardt 1a

INDEX TO APPENDIX
(continued)

Beg. Page No.

APPENDIX B:
Order of the United States District Court for the District of Idaho dated February 14, 1997 . . . . . 1b

APPENDIX C:
First Amended Class Action Complaint filed December 10, 1996 . . . . . 1c

TABLE OF AUTHORITIES CITED

Cases **Page**

Affiliated Ute Citizens v. United States, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972) . . . . . Passim

American Pipe & Construction Co. v. Utah, 414 U.S. 538, 94 S.Ct. 756, 38 L.Ed.2d 713 (1974) 16,17

Basic, Inc. v. Levinson, 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed.2d 194 . . . . . Passim

Crown, Cork & Seal Co. v. Parker,
462 U.S. 345, 103 S.Ct. 2392, 76 L.Ed.2d
628 (1983) 16,17

General Telephone Co. of Southwest v. Falcon,
457 U.S. 147, 102 S.Ct. 2364, 72 L.Ed.2d
740 (1982) 16,17

Hicks v. Stevens,
11 N.E. 241 (Illinois 1887) 21

Loghry v. Coper,
123 N.W.2d 417 (Iowa 1965) 21

United Airlines, Inc. v. McDonald,
432 U.S. 285, 97 S.Ct. 2464, 53 L.Ed.2d
423 (1976) 16,17

Statutes

15 U.S.C. §78aa 1

Regulations

Securities Exchange Commission, Rule 10b-5
17 C.F.R. §240.10b-5 2

Rules

Federal Rules of Civil Procedure,
Rule 23 . . . . . Passim

Federal Rules of Civil Procedure,
Rule 56 1

Other

37 Am.Jur. 2d Fraud & Deceit §228 (1968) 21

27 Wright & Gold, Federal Practice &
Procedure: Evidence 6005 21

Petitioners Albert and Estelle Binder in their individual capacities and on behalf of all persons similarly situated (herein "Petitioner") respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The revised order and opinion of the United States Court of Appeals for the Ninth Circuit is reported at Binder v. Gillespie, 184 F.3d 1059 (9th Cir. 1999) (Appendix A). The order of the Idaho District Court dated February 14, 1997 in *Binder v. Gillespie*, et al, Case No. 94-0528-s-MHW (the "Order") is not published (Appendix B).[1/]

JURISDICTION

The date on which the United States Court of Appeals for the Ninth Circuit issued its revised opinion, and order denying the petition for rehearing and for rehearing en banc, was July 26, 1999.

The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1). The primary basis for jurisdiction in the District Court was under 15 U.S.C. §78aa (Rule 10b-5 claims).

[1/] The second order of Idaho District Court dated July 3, 1997 (the "Second Order") was not published and is not believed to be meaningful for purposes of Court's consideration and action in respect of the within petition. (See "Statement Of The Case - - Procedural Background" herein at page 15).

STATUTES, REGULATIONS AND RULES INVOLVED

This petition implicates Section 10(b) of the Securities Exchange Act of 1934, as amended (the "34 Act"), and United States Securities and Exchange Commission ("SEC") Rule 10b-5 promulgated hereunder (Rule 10b-5). (Section 10(b) and Rule 10b-5 are collectively referred to herein as "Rule 10b-5") in respect of petitioner's submission that petitioner was entitled to a presumption of reliance on the respondents' misstatements as well as omissions in this "mixed" case of misstatements and omissions under this Court's decision in *Affiliated Ute Citizens* (and as referenced and confirmed in *Basic, Inc.*) and, separately, under this Court's decision in *Basic, Inc.* (fraud-on-the-market) because the public trading market for Aqua Vie Beverage Corporation stock which petitioner purchased in such public trading market satisfied all of the requirements of this Court's decision in *Basic, Inc.* The petition also implicates Federal Rules of Civil Procedure ("FRCP") Rule 23 in respect of the petitioner's submission that the lack of a presumption of individual reliance in a Rule 10b-5 public trading market case does not automatically preclude class action treatment and that the named plaintiffs' inability to satisfy the "purchaser or seller" requirement of a Rule 10b-5 action against all of the named defendants in the action does not automatically preclude such plaintiffs from serving as representative for class members who have similar Rule 10b-5 claims as those of the class representatives but against such other defendants. FRCP Rule 56 is also implicated in respect of petitioner's submission that the question of the "efficiency" of the trading market in AVBC stock should have been decided by the jury at trial.

The precise language of the above referenced statute and rules do not appear, however, to directly impact on the Court's decision in respect of the within petition; and, accordingly, such statute and rules are not reproduced in this section of the petition.

STATEMENT OF THE CASE[2/]

Factual Background

The Gillespies conceived of a new bottled water product which they described as a "lightly flavored spring water" product. Prior to such time, they had been marketing an unflavored spring water product from Hawaii. In January of 1991, the Gillespies acquired control of a public shell corporation (The Jib Group, Inc. or "Jib"), and changed its name to Aqua Vie Beverage Corporation ("AVBC" or the "Company"). The Gillespies moved from Hawaii to Sun Valley; and, in early 1991, Tom Gillespie ("Gillespie") hired Diane Karban, who had just passed her CPA exam in Idaho, as AVBC's chief accounting and financial officer. Karban, in turn, engaged Deloitte and Touche's Boise office to serve as AVBC's independent accountants and auditors. Prior to accepting such engagement, Deloitte never asked to and never did meet Gillespie. Deloitte dealt exclusively with Karban

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[2/] The within relevant facts were presented to the Court of Appeals in petitioner's opening brief to such Court together with citations to the record. The facts referenced in the opinion of the Court of Appeals do not appear to be inconsistent with any of the facts contained herein although the statement of facts set forth in such opinion is an abbreviated version of the within summary. Defendant Deloitte acknowledged, in its opposition to the petition for rehearing or rehearing en banc, that AVBC stock was included in the NASD's electronic OTC Bulletin Board trading system during the class period.

throughout 1991 and 1992. Deloitte went about trying to assemble accounting information regarding AVBC's 1990 operations; and Deloitte, with only minimum assistance from Karban, prepared AVBC's 1990 year-end financial statements including footnotes (based on the information Karban was able to get from Gillespie and give to Deloitte). Deloitte certified such AVBC 1990 year-end financial statements. Deloitte also prepared, with little or no assistance from AVBC, the Company's first couple of quarterly reports to the SEC on Form 10-Q. Deloitte thereafter regularly received, commented upon and otherwise participated in the preparation of such 10-Q reports together with "year-end results" and other press releases. Deloitte was referred to by name in AVBC's 1st Quarter 1991 10-Q Report as the Company's accountants who had classified certain of the information appearing in such quarterly financial statements. This Report also included the statement that the Company expected sales of its proposed new product to reach $10 million within 90 days following introduction. AVBC provided copies of its 1st and 2nd Quarter 1991 10-Q's to the petitioner. In 1991, having acquired control of Jib, and having caused public trading of AVBC stock to commence in February of 1991, Gillespie persuaded Frank Lopez, one of the former shareholders of Jib to sell his shares in AVBC in the public market, and to transfer the proceeds in the approximate amount of $700,000 to AVBC to be used as working capital. Lopez was promised but never received, replacement shares from the Company for the AVBC stock sold by him. Instead of recording such transfer of funds by Lopez to AVBC as a loan and recording a liability on AVBC's accounting books and records until such promised consideration was paid by the Company, Gillespie instructed that such funds transfer be reflected as a gift from Lopez, and Deloitte suggested the funds received from Lopez be classified as a "contribution to capital" (even though Lopez

was no longer a stockholder of AVBC following the sale of such stock). Deloitte, not AVBC, wrote a footnote to AVBC's quarterly and 1991 year-end financial statements describing such "contribution to capital" transaction. Deloitte never sent a "confirm" to Lopez or otherwise tried to communicate with Lopez regarding the subject funds transfer. AVBC's audited year-end financial statements reflected that the Company had received $678,589 from Lopez during the course of 1991, and that such funds were a "contribution to capital" from a shareholder of the Company. Lopez, having never received the promised "replacement" stock and having never recovered his money, sued and obtained AVBC's default in respect of such claim. Nevertheless, AVBC never recognized any liability in respect of the funds it received from and owed to Lopez. Ian Wilson was a director of the Company from October 1, 1992 through the end of the class period. Fitchey was associated with the Company for approximately the same period of time. Carey Fitchey used the title of "Office of the President" and he attended all board meetings and otherwise functioned as a senior level executive. Mark Stevens served on the board from May 1993 until the end of the class period. Stevens became President of AVBC in January of 1994, and resigned on February 28, 1994. Gillespie caused AVBC to enter into and announce an arrangement with Golden Brands in respect of distribution of the Company's new product. As part of the arrangement, Golden Brands ("GB") became AVBC's first "master distributor" in July of 1991, and GB agreed to advance funds to have AVBC's water product manufactured by an independent bottling company (Cottell). AVBC agreed to purchase and pay GB for such product to be used by AVBC for the launch of its new product to retail customers, including through the sale of such product to other distributors to be appointed by AVBC. AVBC's standard form of distributor agreement, which GB and

AVBC's subsequent distributors signed, included a provision obligating AVBC, at the option of the distributor(s), to repurchase all of such terminating distributor's saleable, but unsold, AVBC product. Such contingent liability was never reported or otherwise disclosed including in AVBC's financial statements. Prior to the first production run of AVBC's product in the Summer of 1992, AVBC's VP chief of quality control John Good reported to defendants Gillespie and Gordon Sim that the formula for the product was still not yet perfected and, as presently constituted, AVBC's product was most likely to turn brown shortly after it was manufactured based on simulated laboratory tests conducted by Good. Nevertheless, Gillespie and Sim decided to have AVBC go ahead with its initial production run because such product was needed for the scheduled retail launch of AVBC's new product in the late Summer/early Fall of 1992. AVBC never publicly disclosed that it was having any problem with the formula for its product (or that the Company's published pre-launch projections of anticipated sales revenue, ranging from $10 million in the first 90 days to $50-$100 million in first 12-24 months, were subject to any uncertainties). Likewise, AVBC never reported that it was obligated to GB in respect of the product which GB had arranged to be manufactured for AVBC. The initial Summer/Fall 1992 production run of AVBC's product in fact turned brown in the bottle as predicted by Good. AVBC later sought to stabilize the formula by adding an ingredient which was not on the FDA's list of approved chemical additives. Subsequent production runs indicated that, with the use of such additive, the product remained stable for a somewhat longer period of time before discoloring; and, on that basis, AVBC authorized another production run of the product by Cottell. Partly because of the discolored water, and partly because there were very few repeat retail purchases of AVBC's new product, GB

and AVBC knew, as early as the 4th Quarter of 1992, that the launch of AVBC's product had not been successful and that AVBC would, at least, be forced to re-formulate and re-name its product and to select an alternative program for the distribution and marketing of a "new and improved" version of such product. For this reason, and the fact that AVBC had failed to pay GB for the product manufactured by Cottell, despite numerous demands to and broken promises by AVBC, GB resigned as AVBC's distributor in late 1992 (and, thereafter, sued AVBC for amounts the Company owed GB). Through December 31, 1992, GB had accounted for approximately one-half (47%) of all sales reported by AVBC. In connection with GB's resignation, Gillespie, Wilson, and Fitchey confirmed to GB the agreement that AVBC would repurchase all defective (brown water) product remaining in GB and its subdistributors inventory, and all of such distributors' inventory of saleable but unsold AVBC product, for approximately $720,000. AVBC's debt to GB at the end of 1992 was not recorded or otherwise disclosed in AVBC's 1992 (or 1993) year-end financial statements, or in any of AVBC's published quarterly financial statements in 1992 or 1993. Likewise, AVBC did not reflect any expense including any reserve or liability attributable to the defective ("brown") water product (and did not adjust previously reported 1992 3rd and 4th Quarter sales of such product at year-end to reflect the return of such defective product). Without any purchases of product by GB in 1993, following such distributor's resignation at the end of 1992, and with only a few actual sales in the 1st Quarter of 1993, the Company's prior optimistic forecasts were clearly not materializing. In April of 1993, when AVBC's proposed securities offering registration statement was pending and set to go effective with the SEC, Gillespie instructed his accounting department to record approximately $425,000 in sales for the 1st Quarter of 1993

even though such product had not been shipped to or paid for by any customers (and never was). AVBC's accounting department was hesitant to implement Gillespie's instructions, which appeared to be contrary to GAAP and the Company's policy for recording sales, until such accounting treatment was reported to and "cleared" by Deloitte which did not object to such questionable reporting. When none of such 1st Quarter "sales" ever took place and AVBC still had not adjusted 1992 reported sales and/or recorded any loss or liability attributable to its product defect problem and/or obligation to GB through the end of 1992, in the Company's 1992 or 1993 year-end financial statements or in any quarterly financials extending through the 4th Quarter of 1993, AVBC reported in February 1994 that the Company would take a charge for the 4th Quarter of $425,000 "due to two master distributors who did not perform as expected". Thereafter, in AVBC's 1993 10-K Report, AVBC indicated it was recording a $1.7 million charge for the 1993 period attributable to "changing its distributor program" (which was a delayed recognition of the expenses/losses incurred by AVBC dating all the way back to the end of 1992 when GB resigned as a result of the product defect and failed launch of AVBC's product). AVBC had been effectively out-of-business since the end of 1992. Concurrently, Gillespie and Stevens announced the reformulation of AVBC's product to a new "All Natural" product which the Company said it was "rolling out nationwide" and which was expected to generate sales of approximately $14 million and $30 million, respectively, in the first and second years. Later in 1994, AVBC suspended business operations. In February of 1995, a bankruptcy petition was filed against AVBC. AVBC was liquidated in such bankruptcy proceeding. AVBC investors received nothing in respect of their AVBC stock.

The petitioner purchased 3,000 shares of AVBC stock on September 24, 1991 for $4 per share for a total of $12,000, and sold such stock on December 20, 1993 for $.875 per share for $2,625. Throughout the class period, AVBC was a public reporting company, filing periodic reports (10-K's, 10-Q's and 8-K's) with the SEC under Section 12(g) of the Securities Exchange Act of 1934. In September of 1992, AVBC filed and otherwise publicly disseminated a registration statement with the SEC under the Securities Act of 1993 covering the proposed sale of 2,000,000 shares of stock by AVBC (and its management) for $5.35 per share, which registration statement was amended several items through June of 1993 and included the consent of Deloitte for the use of its audit reports on AVBC's 1991 and 1992 year-end financial statement, and AVBC's quarterly financial statement for the three months ended March 31, 1993, which were included as part of such registration statement. During the class period August 1, 1991 through February 28, 1994, AVBC stock traded as high as $4.50 per share and had declined to $0.75 by the end of such period. Throughout the class period, trading in AVBC was in the OTC market and reported on a daily basis, on the NASD's electronic over-the-counter (OTC) "Bulletin Board" trading system and in the "pink sheets" published by the National Quotation Bureau, Inc. In addition to OTC market trading, in December of 1993 AVBC's stock was listed and began trading on the Boston Stock Exchange ("BSE"). Having published projections in 1991 indicating that sales were expected to exceed $50 million in the first twelve months, and in the 1st Quarter of 1991 stating that sales were expected to reach $10 million in the first 90 days following launch, AVBC's reported "sales" during 1992 did not exceed $1.3 million. Such "sales" were actually all fictitious in the sense that AVBC was obligated or otherwise liable for the repurchase of such merchandise due to the defective nature of such product

and/or pursuant to the repurchase provision in the Company's distributor agreements including with GB. For the 1st Quarter of 1993, of reported sales of $800,000, approximately $425,000 of such sales were bogus (non-existent). Accordingly, AVBC never really had any meaningful sales of its product. None of such information was ever reported in any of AVBC's audited year-end financial statements, in any of the Company's published quarterly financial statements or in any of AVBC's other disclosure documents including without limitation in any press release, annual report to stockholders, proxy statement, 10-K, 10-Q, 8-K or in the Company's pending registration statement. During the course of auditing and reporting on AVBC's financial statements, Deloitte never met Gillespie, and dealt exclusively with AVBC's accounting staff. Although Gillespie had no education, background or experience in accounting, Deloitte relied on written representations from Gillespie that the Company's financial statements were accurate and complete to the best of his knowledge. Although Deloitte's audit work papers, including written confirmation from AVBC's independent stock registrar/transfer agent in February of 1992, reflected that the number of AVBC shares issued and outstanding through December 31, 1991 did not include such shares, immediately prior to issuing its audit report on such 1991 financial statements in March 1992, Deloitte allowed AVBC to reflect the issuance of a free grant of 2.5 million shares of stock by AVBC to the Gillespies and Karban deemed effective January 9, 1991 (immediately after Gillespie took control of Jib and prior to the initiation of public trading of AVBC stock) valued for compensation/expense purposes at $.001 per share when the public trading price of such shares was far in excess of such amount.

The allegations of the First Amended Class Action Complaint (the "Complaint") state AVBC's projections of $50 million in sales in the first twelve months, and $10 million in the first 90 days following launch, were insupportable and were at best reckless if not intentionally fraudulent. AVBC did not disclose any information supporting the reasonableness of such projections. Thereafter, AVBC never disclosed any of the information which was known and which demonstrated such projections to be inaccurate. AVBC's financial statements reflected a development stage company which was moving forward in a positive manner when, in fact, just the opposite was true. Deloitte's presence as AVBC's auditor gave investors a false sense of assurance that they could rely upon the Company's published financial information when the opposite was true. AVBC's audited and unaudited financial statements reflected the Company as being in a position to be able to implement its announced business plan so as to obtain projections of profitability. *AVBC's 1992 financial statements should have, but did not, reflect that AVBC was experiencing problems with the formula for its product, and that the initial production runs of such product was defective and such defective product would have to be repurchased or replaced at an estimated cost of at least $180,000. Such financial statements should have reflected the Company's obligation to GB for product supplied by GB (through Cottell) to the Company, in the approximate amount of $500,000. Such financials should have reflected that GB had resigned as a distributor for AVBC's product.* None of this information was disclosed in AVBC's 1992, or 1993, year-end financial statements, rendering such statements and Deloitte's reports thereon false and misleading. AVBC's 1991 statements should have reflected that AVBC had received almost $700,000 from Lopez, without the payment of any consideration by AVBC for such funds, and that a liability in the amount of $700,000

had been recorded to reflect the receipt of such funds (or disputed transaction). If the foregoing had been properly reported in AVBC's 1992 year-end financial statements, investors would have known that AVBC had virtually no actual product sales in 1992, that any future significant sales of the product was in doubt, and that the Company's current liabilities, and the prospect of litigation with Lopez and GB, would seriously impede if not actually prevent the Company from conducting business in the ordinary course in 1993, and for the foreseeable future.

Procedural Background

The action was filed on March 4, 1994. The complaint including the First Amended Class Action Complaint ("Complaint") alleged violations of federal and state securities laws by AVBC, certain of its officers and directors including the Gillespies and defendants Wilson, Fitchey and Stevens (herein sometimes collectively the "O/D Defendants") and Defendant Deloitte.

Default was obtained against the Gillespies on July 15, 1994; and the plaintiffs' motion for default judgement under FRCP Rule 54(b) was granted by the Idaho court on July 3, 1997. Petitioner's motion for class certification under FRCP Rule 23 was granted on August 8, 1996. Sometime after February 1995, defendant AVBC was indicated to be the subject of an involuntary bankruptcy petition, and the instant case did not thereafter proceed against AVBC. The O/D Defendants and Deloitte filed motions for summary judgment on January 9, 1997. Plaintiffs and the class filed cross-motions for summary adjudication against Wilson (on their claims for breach of fiduciary duty only) and against Deloitte (on their Rule 10b-5 and related state law claims). On February 14, 1997,

the court issued its order of decision covering all such motions (the "Order"). The court granted the subject defendants' motions for summary judgement on the plaintiffs and the class' Rule 10b-5 claims under all theories of recovery (except the named plaintiffs' Rule 10b-5 claims based on his individual reliance on misstatements). The court dismissed the class' Rule 10b-5 claims based on individual reliance on misstatements because the court determined that the class was not entitled to rely upon the named plaintiffs' allegations of reliance on misstatements in the Complaint. The court also decided that the case could not proceed as a Rule 23 class action based on the remaining theory of reliance on misstatements because such individual issue would overwhelm the common issues rendering continued maintenance of the case as a class action untenable. The court dismissed the claimants' "omissions" case because the court found that such Rule 10b-5 claims were primarily based on misstatements (as opposed to omissions) and that, where a mixed case of misstatements and omissions is asserted, claimants are not entitled to a presumption of reliance/causation under this Court's decision in *Affiliated Ute Citizens* or *Basic, Inc.* on their fraud-on-the-market theory of recovery because the public trading market in AVBC stock, while such stock was trading in the OTC market, was not efficient (under factors enumerated in the New Jersey District Court case of *Cammer v. Bloom*, 711 F.Supp. 1264 (D.N. J.1989). For the period after December 1993 when AVBC stock began trading on the BSE, the court determined as a matter of law that factors *other than* AVBC's disclosure documents caused 100% of the losses suffered by AVBC investors. Believing that the only theory of recovery available to the claimants required individual reliance on AVBC's disclosure documents, and that such individual reliance based claims could not be established by the named plaintiffs, and that continued Rule 23 treatment was not available to the class

for purposes of their seeking recovery against the respondents, the Idaho District Court indicated that it was, therefore, necessarily compelled to decertify the class. The court also indicated that the lack of any remaining Rule 10b-5 claim by the class against the defendants, in whose favor judgment was being entered, required the court to decline further jurisdiction over the class' state law claims. The court ruled the claimants' cross-motion for summary judgment against defendant Wilson, based on state law, were rendered moot by the Order; and the court denied, without explanation, such claimants' cross-motion for summary judgment on their Rule 10b-5 and related state law claims against Deloitte. In light of the foregoing decision granting summary judgment in favor of respondents on the claimants' mixed misrepresentations and omissions case including fraud-on-the-market claims, the court refused to entertain further jurisdiction over the class' individual reliance based claims and the class' pendant state law claims; and the court decertified the class. The court subsequently confirmed that, by its Order, it intended to retain jurisdiction over the named plaintiffs' individual state law claims against the defendants (even though the court had declined to exercise jurisdiction over the class' state law claims against such defendants). Addressing the plaintiffs' remaining individual reliance and state law claims, the court indicated that it did not find "persuasive" the plaintiffs' evidence that Deloitte had any *substantive* involvement in the preparation of AVBC's quarterly financial statements and reports on Form 10-Q, so the court confirmed its prior finding and conclusion limiting the parameters of the plaintiffs' claims only to possible misstatements in, and the plaintiffs' individual reliance on, AVBC's year-end audited financial statements. In this regard, the court determined that the plaintiffs had already purchased their AVBC stock prior to the issuance of AVBC's 1991 year-end financial statements which was the

first such audited financial statements which the plaintiffs alleged they had read and relied upon (as opposed to the 1st Quarter 10-Q Report which was indicated to be unaudited), and prior to the date that Deloitte maintained AVBC's 1990 year-end financial statements had been filed with the SEC. Accordingly, the court determined that the "in connection with" element of Rule 10b-5 could not be satisfied in respect of plaintiffs' stock claim against Deloitte. The court, likewise, determined that the AVBC corporate disclosure information, including financial statements, upon which the plaintiffs could have actually relied in deciding to purchase AVBC stock, had been published prior to the time that the O/D Defendants (Wilson, Fitchey and Stevens) had any involvement with AVBC and that, consequently, plaintiffs could not satisfy the "in connection with" requirement in respect of such Defendants. The court did not address such Defendants' duty to disclose or correct, or fraudulent course of conduct, as a basis for recovery by the plaintiffs against such Defendants - - only the plaintiffs' ability to recover on their individual reliance on misstatements claims).

In a Second Order issued by the court, the Idaho District Court further concluded as a matter of law that AVBC's audited financial statements were not the cause of any injury suffered by the plaintiffs. Having concluded that dismissal of plaintiffs' individual Rule 10b-5 claims against the respondents was required, the court declined to retain jurisdiction over any of the named plaintiffs' state law claims against any of the defendants - - notwithstanding that the court determined at the same time to retain jurisdiction over state law claims against several of the other O/D defendants (including Karban, Good and Sim) because the court was not dismissing the named plaintiffs' claims against such other defendants. Having dismissed all of the plaintiffs' federal, and declined to retain jurisdiction over

any of the plaintiffs' state law, claims against the respondents, on July 3, 1997 the court entered final judgment in favor of such respondents under Rule 54(b). The named plaintiffs' Rule 10b-5 and state law claims against defendants Gordon Sim, Diane Karban and John Good remain pending before the court, but are being held in abeyance pending determination of the instant appeal.

REASONS FOR GRANTING THE PETITION

The opinion of the Ninth Circuit Court of Appeals which is the subject of this petition, includes decisions of important questions of federal substantive and procedural law applicable to this Rule 10b-5 securities class action case which are in conflict with relevant decisions of this Court; including *Basic, Inc. v. Levinson, Affiliated Ute Citizens v. United States, General Telephone Co. of Southwest v. Falcon, American Pipe & Construction Co. v. Utah and Crown Cork & Seal Co. v. Parker.*

To the extent that any of the matters decided by the Court Of Appeals on important questions of federal law as presented by this petition are determined not be in direct conflict with prior decisions of this Court, it is respectfully submitted that such questions are of such compelling national importance that the Court should grant this petition and settle such questions.

The questions presented are important and compelling as they affect the substantial number of Rule 10b-5 securities and other class action cases processed by the courts each year, the efficient system-wide administration of such cases and continued implementation of the anti-fraud purposes and objectives of the federal securities laws implicated by this petition for the protection

of the United States' capital markets and investors therein. In the past, this Court has reviewed and offered guidance in respect of the courts of appeal interpreting and applying FRCP Rule 23 in a manner which this Court believed did not fulfill the intended purpose and objective of such Rule. *American Pipe & Construction Co. v. Utah , Crown Cork & Seal Co. v. Parker, United Airlines, Inc. v. McDonald and General Telephone Co. of Southwest v. Falcon.*

For the reasons set forth herein, the Court is respectfully requested to grant this petition and decide the within important and compelling federal questions.

Claimants Were Denied The Presumption Of Individual Reliance Afforded Them Under Affiliate Ute

The majority cites *Affiliate Ute Citizens* as the basis for denying the claimants the benefit of a presumption of reliance in their mixed omissions and misrepresentations case which the Idaho District Court characterized as "not primarily an omissions case". Appendix, page 14a.[3/]

[3/] In *Affiliate Ute* involving both a material omission and a material misrepresentation, this Court indicated that positive proof of reliance is not a prerequisite to recovery if undisclosed facts would be material to reasonable investors. The majority's holding in this case, that *Affiliate Ute* should be restricted to cases involving "primarily omissions" may be as a result of an over emphasis on "omissions" (as opposed to undisclosed material facts resulting from misrepresentations as well as by way of "omission"). In *Basic, Inc.*, the Court appears to have indicated that *Affiliate Ute* should not be read to apply only to "omissions" (or "primarily omissions") as opposed to "misrepresentations" cases ("we previously have dispensed with a requirement of positive proof of reliance, where a duty to disclose material information has been breached, concluding that the necessary nexus between the plaintiff's injury and the defendant's wrongful conduct has been established") 485 U.S. at 243.

The Affiliated Ute presumption of reliance applies equally to misrepresentations and omissions. As Judge Reinhardt noted in his dissent on this point,

> "[t]he categories of 'omission' and 'misrepresentation' are not mutually exclusive . . . All misrepresentations are also nondisclosure, at least to the extent that there is a failure to disclose which facts in the misrepresentation are not true. Thus, the failure to report an expense item on an income statement, when such failure is material in the *Affiliated Ute* sense, can be characterized as (a) an omission of a material expense item, (b) a misrepresentation of income or (c) both."

Judge Reinhardt goes on to say that,

> "Omissions and misrepresentations both deprive the investor of truthful information relevant to the investment decision, and both result in the artificial pricing of a stock",

> "Most important for our purposes here, it is equally difficult to establish reliance on a misrepresentation and on an omission. While a plaintiff in an omissions case - - absent the Affiliated Ute presumption - - would bear the daunting task of proving 'I would not have bought/sold had I known what you failed to tell me . . . the plaintiff in a misrepresentation case bears the equally daunting burden of proving I would not have bought/sold had I know what you failed to tell me; namely, the truth'. In either case, the plaintiff must prove that he would have acted differently if he had known something that he did not actually know, i.e., the full truth."

> "In an omissions case, the plaintiff does not know the truth because the defendant said nothing; in a misrepresentations case the plaintiff does not know the truth because the defendant lied. But, as far as the plaintiff's ability to demonstrate reliance, this is a distinction without a difference. In either case, the plaintiff must attempt to prove that he would have acted differently had he known the truth. The evidentiary burden is therefore equally difficult in either case, and there is no logical reason to afford the presumption of reliance to plaintiffs in omissions cases but not in misrepresentations cases. The rule . . . that the 'causal nexus can be adequately established indirectly, by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock' . . . applies with equal force of logic to misrepresentations."

Judge Reinhardt concludes by stating

> "*Affiliate Ute* recognized the inherent difficulty of proving reliance in securities fraud cases, and accordingly announced a rule of presumed reliance in a mixed omissions and misrepresentations case . . . [P]laintiffs face the same difficulty in proving reliance on misrepresentations. I would therefore hold that plaintiffs in mixed cases are entitled to the *Affiliate Ute* presumption of reliance whether the case is primarily an omissions case or primarily a misrepresentations case. Accordingly, whether this case is properly classified simply as a mixed omissions and misrepresentations case, or as 'primarily' a misrepresentations case, I would hold that the Binder class was entitled to a presumption

> of reliance, and would therefore reverse the decertification of the class. [footnote omitted]".

This Court's "fraud-on-the-market" presumption of reliance as enunciated in *Basic, Inc.* does not differentiate between fraud occasioned by "omissions" versus "misrepresentations" and resulting nondisclosure. In *Basic*, referring to *Affiliated Ute*, this Court confirmed that, "we previously have dispensed with a requirement of positive proof of reliance, where a duty to disclose material information has been breached, concluding that the necessary nexus between the plaintiff's injury and the defendant's wrongful conduct has been established". 485 at 243.

Reliance on this Court's decision in *Affiliated Ute*, which was not a class action case (but face-to-face setting), to preclude the application of the judicial prerogative of a presumption of individual reliance in the context of this Rule 23 public trading markets case, combined with the erroneous conclusion that this Court's decision in *Basic, Inc.* precludes Rule 23 status absent the availability of a presumption of individual reliance[4], presents this Court with a compelling reason to grant the within petition and decide the issues presented by this case.

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[4] "[I]f a presumption is not allowed or is inapplicable the court would be required to decertify the class because individual issues of fact would predominate, thus rendering the class status untenable". Order (Appendix B) at page 17.

The Majority's Decision Is In Conflict With The Common Law Rule That Reliance May Be Inferred From The Materiality Of A Misrepresentation Or Omission

Under Common law, difficulties associated with relying on the claimant's own testimony led to the rule that reliance was best established as a result of the material nature of the fraud rather than the claimant's testimony as to what he would have done had he know the truth. See 27 Wright & Gold, *Federal Practice & Procedure: Evidence* 6005 at 57-58 (1990).[5/]

Proof Of Individual Reliance Does Not Necessarily Preclude Class Action Treatment

Virtually every Rule 10b-5 public trading markets case involves both misrepresentations and omissions and could be "characterized" as not involving primarily omissions thereby denying the plaintiff (and the class) of the benefit of a presumption of reliance and thus, according to the instant decision, treatment as a class action under Rule 23.[6/]

[5/] The majority decision is in conflict with centuries of common law holding that reliance may be inferred from the materiality of a misrepresentation or omission. See, e.g., *Loghry v. Capel*, 132 N.W.2d 417, 421 (Iowa 1965) (reliance inferred from materiality of omission); *Hicks v. Stevens*, 11 N.E. 241, 243 (Illinois 1887) (reliance "presume[d]" from materiality of misrepresentation). See also, 37 Am.Jur.2d *Fraud & Deceit* §228 at 305 (1968). Such common law principle was adopted by this Court in *Affiliated Ute* for claims under Section 10b-5. 406 U.S. at 153-54.

[6/] The Idaho Court quoted (Appendix at page 18b) the following language in *Basic*, apparently used by this Court to explain why it was appropriate to endorse the use of a presumption of indirect reliance on the

(continued...)

Accordingly, the majority's decision which is the subject of this petition appears to be inconsistent with this Court's decision, and/or the rationale underlying such decision as it relates to the application of a presumption of reliance in the context of a Rule 23 public trading markets securities case, in *Affiliate Ute* as confirmed in *Basic*. Moreover, application of this published decision in the Ninth Circuit and elsewhere will seriously erode the protections Congress and this Court have afforded to victims of securities fraud.

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[*] (...continued)
integrity of the market (tainted by the corporation's material omissions): "In approving the theory's presumption [fraud-on-the-market], the Supreme Court concluded that 'requiring proof of individual reliance from each member of the proposed class effectively would have prevented [plaintiffs] from proceeding with a class action, since individual issues would have overwhelmed the common ones'". 485 U.S. at 242. The irony of the court's decision is that, in foreclosing the claimants' use of a presumption of reliance on information withheld based on the "mixed case" rationale (adopted in only a very few cases in the 25 years since *Affiliated Ute* was decided, namely that a mixed case of misrepresentations and omissions does not present the claimant with the same difficulty of proof which would apply to an omissions only (or primarily an omissions) case which practical difficulty gave rise to the use of such presumption by courts as a way to facilitate intended recovery under Rule 10b-5), the court used the presumed "not so difficult proof" case and turned it into the "ultimate difficulty of proof" case by refusing to allow the case to proceed under Rule 23 as a result of the court's denial of such presumption of reliance decision and the court's misreading or misunderstanding of the language from this Court's decision in *Basic*.

The Characterization of This Case As "Not Primarily An Omissions Case" Is Not Accurate, Is Inconsistent With The Court's Own Description Of The Nature of The Case; And Such Approach Is Not Workable And Is In Any Event Unnecessary

Although the District Court in its Order generally described the gravamen of the plaintiffs' claims as a "failure to disclose" case, for purposes of denying the plaintiffs and the class the benefit of individual reliance for their Rule 10b-5 claims, the court then "characterized" plaintiffs' claims as "not primarily an omissions case".[7/] The majority said that they "do not disagree" with the District Court's characterization of the case. Appendix, page 12b.[8/] Neither the District Court or the majority in the opinion of the Court of Appeals provided any explanation, analysis, methodology, guidance or other comment as to why the instant action should be properly characterized as "not primarily an omission case". The gravamen of the case, as

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[7/] At the outset of its decision (Appendix, page 4b), the District Court stated that,

> "Essentially, Plaintiffs contend that over a two and a half year period AVBC created an overly optimistic picture of its future profitability in its public statements and thereby artificially inflated its stock price. *Plaintiffs contend that these projections were misleading when made because AVBC possessed adverse information at the time that it failed to disclose.*"
> (emphasis added).

[8/] The majority opinion: "The district court . . . characterized Binder's action as "not primarily an omissions case" and held that the *Affiliated Ute* presumption was unavailable. We agree with the district court's characterization of Binder's action. Binder's complaint contains both allegations of omissions and misrepresentations, and at the very least, must be characterized, as the district court noted, as "a mixed case of misstatements and omissions."

alleged in the complaint (Appendix C) and as maintained for purposes of the parties' cross motions for summary judgment, was that the O/D defendants knew, and Deloitte knew or was extremely reckless in not knowing that the formula for the AVBC water product was defective, that the water would and did actually turn brown in the bottle and that such product defect represented a contingent and actual liability adversely affecting AVBC's business, financial condition and prospects for success - - and that the Company's projections were, therefore, totally unrealistic if not intentionally fraudulent. None of such product defect and resulting information was ever disclosed to AVBC's investors. The instant case involves, as the District Court first indicated, a "failure to disclose" materially adverse information - - which information "touched-up" and actually caused AVBC's demise as a viable business proposition and investment.[9/]

The lack of guidance as to what constitutes an omission and a misrepresentation in the context of a securities fraud case, and the practical difficulty in distinguishing between the two, combined with the court's determination (citing *Basic, Inc.* as controlling authority) that the lack of a presumption of reliance precludes class action treatment in Rule 10b-5 cases, threatens the viability of most if not all of such claims and recovery for securities fraud as enunciated by this Court during the last decade.

[9/] The District Court apparently failed to realize that the publication and dissemination of AVBC's audited financial statements, which did not disclose such contingent and resulting actual liability in respect of such product defect, prior to and after the listing of AVBC's stock for trading on the BSE was the cause of AVBC's ultimate demise failure and the loss suffered by AVBC's investors.

Of course, this confusion should and would be eliminated if the Court grants the within petition and clarifies the questions presented hereby.

Claimants Were Denied The Fraud-On-The-Market Presumption Of Reliance Afforded Them Under Basic, Inc.

Basic, Inc. established that claimants are entitled to a presumption of reliance where such investors can be assumed to have relied on the efficiency and integrity of the public trading market for securities purchased at prices which were inflated by information introduced into such public trading market by defendants (who were under a duty to ensure the accuracy of such information) regardless of whether any resulting inaccuracy was the result of a "misrepresentation" and/or "omission". The concept underlying such judicial presumption is that efficient trading markets, by nature, will avail themselves of all available material information in determining the price at which securities are bought and sold.

The "efficient market" theory is not intended to be scientifically perfect in the context of judicial proceedings. It is an enabling rationale for the judicial presumption which enables the courts to more efficiently process these kinds of public trading market cases. The presumption is rebuttable. In determining whether any particular security is entitled to the indirect reliance or "fraud-on-the-market" presumption, whether such security is traded on a securities exchange or in the over-the-counter securities market, the threshold issue is whether or not information regarding the security and the issuer is available to participants in the trading market for such security. If so, it is logical to presume that professionals trading in such market will avail themselves of such information in determining the prices at

which they will buy and sell such security. Although it is true that AVBC stock was traded in the over-the-counter-market, at all times during the class period such Company was "an SEC reporting company" under the Securities Exchange Act of 1934 (and filed a Registration Statement with the SEC on Form S-1 under the Securities Act of 1933). At all times during the class period, AVBC stock was included in the National Association of Securities Dealers' Automated Quotation System OTC Bulletin Board system - - also referred to as the "over-the-counter" market. Such established, national electronic securities trading market (comprised exclusively of licensed securities professionals trading for their own account and the accounts of their customers) reports daily volume and prices for securities, including AVBC, included in such system.

The majority decision that the fraud-on-the-market presumption of reliance cannot apply because "Binder offered evidence only as to the presence of market makers and arbitragers" conflicts directly with the Supreme Court's holding in *Basic* that, "[f]or purposes of accepting the presumption of reliance . . . we need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock prices". 485 U.S. at 246.[10/] For purposes

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[10/] The majority (Judge Reinhardt did not join in the fraud-on-the-market portion of the opinion) says that, "[t]he question is whether such a market is efficient - - whether the stock price reflects public information". Appendix at page 5a. The majority then purports to apply a "test" for efficiency from *Basic*, demanding "empirical facts showing a cause and effect relationship between unexpected corporate events and or financial releases and an immediate response in the stock price". But *Basic* adopts no such test. Indeed, in *Basic* this Court emphasized that, "[w]e need not determine by adjudication what economists and social scientists have debated through the use of sophisticated statistical analysis and the application of economic theory". 485 at 246, fn. 24. (For the record, plaintiffs submitted expert

(continued...)

of the application of the fraud-on-the-market presumption of reliance established by this Court in *Basic*, the securities of any company which is an SEC public reporting company (availability of the information which the SEC has determined to be important to the market for publicly traded securities) which trade in an impersonal, well-developed, open national securities trading market like the NASD Bulletin Board should be deemed to be trading in an "efficient market".

Petitioner was entitled to the benefit of the fraud on the market presumption of reliance enunciated by this Court in *Basic*, and the majority's opinion is contrary to the Court's determination on this important point of federal securities law and merits the granting of this petition.

A Rule 23 Representative Does Not Have To Have Claims Against The Exact Same Defendants As The Class

General Telephone v. Falcon established that a class representative does not have to possess the same claims against all of the same defendants, as each member of the class so long as common issues of fact and law predominate (which will normally be the case in a public trading securities case). Thus the fact that the petitioner bought AVBC stock following the date some of the class members

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[10/] (...continued)
testimony in response to the defendants' motions for summary judgment opining that the OTC market during the class period was "efficient" being an open, developed, national, impersonal securities trading market. Plaintiffs' also submitted a time and price summary of published newspaper reports reflecting the date of AVBC public announcements and the price movement of AVBC stock in response thereto showing the correlation underlying the economic principle of efficient markets - - which summary the District Court apparently declined to accept because the summary was not prepared by a person qualified as an expert).

petitioner was previously authorized to represent, and therefore could not satisfy Rule 10b-5's "purchaser or seller" requirement in respect of his individual claims as to all of the defendants, should not automatically disqualify him from pursuing not only his own Rule 10b-5 claims against the certain defendants remaining in the case following the Court's Order but also serving in a representative capacity for class members who have similar claims against other defendants. In justifying decertification of the class and dismissal of all of the class' Rule 10b-5 claims, solely on the basis that Binder could not maintain individual claims against all of the same defendants because he could not satisfy the purchaser or seller requirement as to all of such defendants, the majority opinion again failed to follow precedent of this Court.

CONCLUSION

The Court is respectfully requested to grant the within petition and clarify as necessary its prior decisions in *Affiliated Ute* and *Basic* so as to confirm the legal precedent established by such decisions on important questions of federal substantive and procedural law. The majority decision which is the subject of this petition affirms the Idaho District Court's misunderstanding of FRCP Rule 23 and Supreme Court cases interpreting such cases. The courts below concluded that, absent a presumption of reliance, no securities class action can proceed as such because the need for proof of individual reliance necessarily precludes maintenance of the case as a Rule 23 class action. Read together, the majority's belief that a presumption of reliance is available only in omissions or primarily omissions cases and that proof of individual reliance in a Rule 10b-5 case necessarily precludes class

action treatment under Rule 23 leaves most Federal securities law claimants without a remedy for fraud. The language in *Basic* which the Idaho court indicated it believed precluded class treatment ("requiring proof of individual reliance from each member of the proposed class effectively would have prevented [plaintiffs] from proceeding with a class action, since individual issues would have overwhelmed the common ones") is understood to have been intended by this Court not as a statement of the standard for class certification under Rule 23 for which it was adopted by the courts below, but as an acknowledgement of the realities of the practical difficulty of proof in securities class action cases justifying the adoption and liberal use of appropriate evidentiary presumptions.

For the reasons set forth herein, the Court should grant this petition.

Dated: October 23, 1999

Respectfully submitted,

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